



STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

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To: The Honorable Donald L. Carcieri, Governor
The Honorable William J. Murphy, Speaker of the House
The Honorable William V. Irons, President of the Senate

From: Rosemary Booth Gallogly, State Budget Officer *RB Gallogly*
Michael O'Keefe, House Fiscal Advisor *Michael O'Keefe*
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Date: December 4, 2003

Subject: November 2003 Consensus Revenue Estimating Conference

Summary

The Revenue Estimating Conference (REC) met October 30, November 3 & 6, and November 10 in open public meetings. At the October 30 meeting, the conferees adopted a consensus economic forecast for 2003 to 2012 based on testimony provided to the REC by the state's economic consultants. The conferees agreed that the state's economy has been stable over the past six months and is poised for strong growth in employment over the FY 2005 – FY 2007 period.

At the November 10 meeting, the conferees revised the enacted revenue estimates for FY 2004 and prepared the first estimates for FY 2005. The conferees lowered the enacted FY 2004 revenue estimates by \$20.5 million based on preliminary revenues collected for FY 2003, actual revenue collections through October 2003, testimony provided by the Division of Taxation and the Lottery Commission, and the revised economic forecast. The FY 2004 revised revenue estimate is \$2.785 billion.

Also at the November 10 meeting, the conferees estimated FY 2005 total general revenues to be \$2.789 billion, an increase of \$4.4 million, or growth of 0.2 percent. The FY 2005 estimates are based on current law, which includes the expiration of the hospital licensing fee. Tables showing the estimates and the changes are included at the end of this report.

Economic Forecast

The Conferees met with the consulting economists from Global Insight and Economy.com, David Pace and Steven Cochrane, respectively, on October 30 to review economic forecasts and assess the current and future state of Rhode Island's economy. The consultants began with an assessment of the U.S. economy before each discussed the Rhode Island economy in detail. The economic consultants were followed by Robert Langlais of the RI Department of Labor and Training who provided the conferees with an in depth analysis of the State's labor market.

The U.S. Economy

The economists concur that the U.S. economy is improving and will continue to strengthen in FY 2005 and beyond. The sources of U.S. economic growth are historically low interest rates that have kept housing and vehicle markets strong, large tax cuts that have boosted disposable income and jump started investment spending, and exceptionally strong productivity growth that has helped to improve corporate profitability. In spite of these positive changes in the U.S. economy, firms have not yet begun to hire workers and thus the recovery through September has been a jobless one. Economy.com forecasts that the annualized percent change in real U.S. GDP will be 3.9 percent in 2004 and 3.0 percent in 2005. Global Insight assigns a 60 percent probability that its baseline forecast would be met. Global Insight's baseline forecast is for real U.S. GDP growth of 4.2 percent in 2004 and 3.7 percent in 2005.

The Rhode Island Economy

The Conference focused its attention on the Rhode Island economy. The State's economic consultants agreed that Rhode Island had avoided the worst of the national recession. Although this is good news, the downside is that neither Global Insight nor Economy.com believe that Rhode Island will experience much of a bounce from the national economic recovery. Quite simply, by avoiding the worst of the national recession, Rhode Island is unlikely to experience the best of the national recovery.

Economy.com

Steve Cochrane reported that the Rhode Island economy was flat through September 2003. Rhode Island's housing market has been steady and, as a result, so has Rhode Island consumer spending. Rhode Island technology employment has been falling but retail trade employment has grown sharply. Among the northeastern states, Rhode Island's economy, along with only those of New Hampshire and New Jersey, has shown growth in base employment and that growth has been at an accelerating rate. Rhode Island's employment performance, however, has been the most balanced showing a strong increase in the rate of growth in employment and solid growth in overall employment. New Hampshire, on the other hand, has shown a sharp increase in the rate

of employment growth with sluggish growth in overall employment while New Jersey's growth in overall employment has been strong but the rate of growth has been subdued.

Global Insight

David Pace reported that Rhode Island total employment in September 2003 was up only slightly from January 2003 levels (481,000 in September 2003 vs. 480,000 in January 2003). Since hitting its peak in February 2001, Rhode Island employment is down less than 1,000 jobs through September 2003. Existing single family median home price in Rhode Island was up 15.0 percent in 2002 and is expected to rise a further 8.9 percent in 2003. The following chart compares Rhode Island's relative economic performance to Connecticut, Massachusetts, and the United States in employment growth year over year for September, income year over year 2nd quarter of 2002 and 2003, and the September unemployment rate.

Global Insight Relative Economic Performance			
	Employment Growth	Income Growth	Unemployment Rate
Rhode Island	0.2%	3.1%	4.5%
Connecticut	-1.3%	2.1%	5.0%
Massachusetts	-1.5%	0.5%	5.7%
United States	-0.2%	2.8%	5.8%

Department of Labor and Training

Rhode Island's unemployment rate peaked at 5.7 percent in June and has fallen in each of the last three months to its September 2003 level of 4.5 percent. This level represents the lowest unemployment rate since September 2001. Rhode Island's seasonally adjusted unemployment rate has been below that of the United States as a whole for 26 consecutive months. The breakdown in Rhode Island employment by selected sector is shown below:

Total Non-Farm Employment in Rhode Island (Thousands, Unadjusted)				
	Sep 2003	Sep 2002	Change	
			Number	Percent
Construction	21.3	20.3	1.0	4.9%
Manufacturing	60.3	62.2	-1.9	-3.0%
Wholesale/Retail Trade	72.0	69.8	2.2	3.2%
Financial Activities	32.7	32.6	0.1	0.3%
Educational Services	17.4	18.3	-0.9	-4.9%
Health Care	70.8	69.2	1.6	2.3%
Government	64.7	65.2	-0.5	-0.7%

The Consensus Economic Forecast

Legislation enacted by the 1998 Assembly amended the Revenue Estimating Conference statutes to require a consensus economic forecast. That forecast appears in the table below.

Annual Growth	CY 2001	CY 2002	CY 2003	CY 2004	CY 2005
Nonfarm Employment	0.4	0.1	0.5	1.0	1.5
Personal Income	4.3	3.8	3.7	3.6	3.8
Wage and Salary Income	3.2	3.1	3.5	3.3	4.8
Farm Income	-55.6	25.0	0.0	0.0	0.0
Nonfarm Business Income	3.0	5.6	7.3	6.8	6.1
Dividends, Interest and Rent	2.5	0.9	-0.3	1.5	2.3
Total Transfer Payment	11.1	10.6	6.6	3.9	1.1
Rates					
Unemployment Rate (RI)	4.8	5.1	5.4	5.3	5.0
Consumer Price Index (US)	2.8	1.6	2.3	1.1	1.6
Ten Year Treasury Notes	5.0	4.6	4.0	4.7	5.2
Three Month Treasury Bills	3.4	1.6	1.0	1.2	2.6
Annual Growth	FY 2001	FY 2002	FY 2003	FY 2004	FY 2005
Nonfarm Employment	1.6	-0.3	0.4	0.8	1.3
Personal Income	6.1	3.5	4.0	3.3	3.9
Wage and Salary Income	5.5	2.5	3.9	2.4	4.7
Farm Income	-66.7	0.0	0.0	0.0	0.0
Nonfarm Business Income	3.3	4.3	6.4	7.5	6.4
Dividends, Interest and Rent	7.2	0.5	0.4	0.4	2.1
Total Transfer Payment	6.9	12.1	8.3	5.4	2.2
Rates					
Unemployment Rate (RI)	4.4	4.9	5.3	5.2	5.0
Consumer Price Index (US)	3.4	1.8	2.2	1.3	1.5
Ten Year Treasury Notes	5.4	5.0	4.0	4.4	5.0
Three Month Treasury Bills	3.4	1.8	2.2	1.3	1.5

With respect to employment growth, the November 2003 REC projects total non-farm employment growth of 0.8 percent in FY 2004 and 1.3 percent in FY 2005, both 0.1 percent higher than the growth rates agreed upon at the May 2003 Conference. These differences equate to an additional 480 jobs in FY 2004 and an additional 489 jobs in FY 2005. The November 2003 Conference forecasts that personal income will grow very modestly over the FY 2004 – FY 2005 period, with growth in excess of inflation of 2.0 percent in FY 2004 and 2.4 percent in FY 2005. These predictions are stronger than that of the May 2003 REC forecast which projected real personal income growth rates of 1.4 percent in FY 2004 and 1.9 percent in FY 2005. The November 2003 Conference forecasts consumer price inflation to remain below 3.0 percent for the entire forecast horizon. This is consistent with the inflation forecast of the May 2003 REC.

Revenue Estimates

Taxes. Revenues from taxes are estimated to increase 5.5 percent in FY 2004 from preliminary FY 2003 tax collections and grow 4.6 percent in FY 2005 over the revised FY 2004 estimate. Total estimated taxes for FY 2004 of \$2,122.7 million are \$3.1 million below the FY 2004 enacted level. FY 2005 total estimated taxes are \$2,221.2 million, \$98.5 million above the revised FY 2004 estimate.

Personal Income Tax. The revised estimate of \$854.9 million for FY 2004 and the first estimate of \$893.1 million for FY 2005 represent growth rates of 5.1 percent from preliminary FY 2003 personal income tax collections and 4.5 percent from the revised FY 2004 estimate respectively. These growth rates assume that the effective income tax rate for the 2003 and 2004 tax years will be 25.0 percent of Rhode Island taxable income.

Business Taxes. The Conference's revised FY 2004 estimate of total business tax collections is \$226.3 million, a growth rate of -1.5 percent from preliminary FY 2003 collections, and its initial estimate for FY 2005 is \$255.8 million, a growth rate of 13.0 percent from the revised FY 2004 estimate. The FY 2004 November REC's revised estimate is \$11.0 million below the enacted FY 2004 estimate. The overwhelming majority of this shortfall is accounted for by an estimated decrease in financial institutions taxes of \$15.0 million. This large estimated decrease reflects the fact that a large financial institution has an overpayment of \$21.5 million in taxes on account with the Division of Taxation. This company has applied for a refund of \$10.8 million effective November 2003 for the 2002 tax year and the conferees assumed that the remaining \$10.7 million on account with the Division of Taxation would be claimed for the 2003 tax year. The FY 2005 November REC estimate for financial institutions taxes is \$22.0 million above the FY 2004 estimate and in line with past collections.

Sales Tax. The conferees revised FY 2004 estimate for sales tax revenues is \$816.0 million, an increase of \$38.1 million, or 4.9 percent, over preliminary FY 2003 collections. The November REC revised FY 2004 estimate is \$3.8 million, or 0.5 percent, above the enacted FY 2004 estimate. The increase in the FY 2004 estimate reflects strong fiscal year-to date sales tax collections due to federal tax rebates paid out in the late summer and the flurry of mortgage re-financing that also occurred at this time. The initial estimate for FY 2005 is \$850.0 million. The November REC initial estimate for FY 2005 represents growth of \$34.0 million, or 4.2 percent, over the revised FY 2004 estimate.

Sales tax collection data available to the conferees for September and October is potentially understated due to difficulties with the 1.0 percent additional tax on meals and beverages that took effect on August 1, and which is to be distributed back to the cities and towns where the sales occurred. It appears that a substantial number of filers did not provide sufficient information with their returns to allow the Division of Taxation to segregate this component. Rather, the Division held approximately \$4.5 million in September and \$5.0 million in October as potential revenues for that source, which is well above the amount anticipated to be due to this additional tax.

Other Sales and Use Taxes. The conferees revised FY 2004 estimate for other sales and use taxes is \$181.3 million and the initial estimate for FY 2005 is \$178.1 million. Other sales and use taxes include motor vehicle fees, cigarette, and alcohol excise taxes. The revised November FY 2004 estimate is \$3.0 million above the enacted FY 2004 estimate adopted by the General Assembly in July. This slight difference between the revised November FY 2004 estimate and the enacted estimate is due to an increase of \$2.2 million in the forecast for cigarette tax collections. At the November 2003 REC, the conferees agreed that the drop in cigarette consumption for the first four months of FY 2004 has been below expectations. The increase in other sales and use taxes for FY 2004 is largely attributable to a forecasted increase in motor vehicle fees due to the wave of new car buying that has occurred over the past two years.

In FY 2005, the principals adopted an estimate for other sales and use taxes that is \$3.2 million less than the revised FY 2004 estimate. The primary driver of this decrease is a lower estimate for cigarette tax collections of \$5.1 million. More than half of this decrease is due to the fact that in FY 2004 nearly \$3.0 million of total estimated cigarette tax collections is from the cigarette floor stock tax. Under current law, this revenue source will not be repeated in FY 2005.

Other Taxes. The Conference's revised FY 2004 estimate for inheritance, racing and athletics, and realty transfer taxes is \$44.2 million. The initial estimate of these taxes for FY 2005 is also \$44.2 million. The revised November FY 2004 estimate is \$0.4 million below the enacted FY 2004 estimate. The decrease from the enacted FY 2004 estimate is a result of the conferees lowering the estimate for inheritance tax collections by \$2.2 million. This decrease is offset by an increase in the estimate for realty transfer taxes of \$1.9 million. The lack of growth in these revenue sources for FY 2005 is attributable more to the unpredictable nature of the inheritance tax, collections for which have been held constant in FY 2005, than any other factor.

Departmental Receipts. The estimators adopted a revised estimate of \$287.0 million for FY 2004 and an initial estimate of \$227.8 million in FY 2005 for the departmental receipts category. These receipts include licenses and fees, fines and penalties, sales and services, and miscellaneous departmental earnings deposited as general revenues. The revised November FY 2004 estimate is an insignificant decrease of \$0.3 million from the enacted FY 2004 estimate. The initial FY 2005 estimate is a decrease of \$59.2 million from the revised FY 2004 estimate. It should be noted that the conferees are limited to estimating revenues under current law and current law specifies for the expiration of the hospital licensing fee in FY 2005. The revised FY 2004 estimate for this fee is \$62.3 million and thus the decrease in departmental receipts in FY 2005 is more than accounted for by the expiration of this fee at the end of FY 2004. Finally, at the May 2003 Revenue Estimating Conference, the principals agreed to adopt a single estimate for departmental receipts rather than separate estimates for each component.

Other Sources. Other source revenue consists of transfers to the general fund from motor fuel taxes deposited in the transportation fund, the lottery, unclaimed property, and other miscellaneous sources, including tobacco settlement payments under the Master Settlement Agreement. The conferees' revised FY 2004 estimate for these revenue sources is \$375.2 million and the initial FY 2005 estimate is \$340.4. The revised November FY 2004 estimate is a decrease of \$17.4 million over the enacted FY 2004 estimate. This decrease is due to a

downward revision in the lottery transfer to the general fund of \$18.7 million adopted by the Conference's principals. The declines in lottery revenues are offset slightly by an upward revision in the unclaimed property transfer of \$1.6 million.

The November initial FY 2005 estimate is \$34.8 million less than the revised November FY 2004 estimate due to large decreases in other miscellaneous revenues and the unclaimed property transfer to the general funds. The large decrease in other miscellaneous revenues is largely attributable to the non-recurrence of the \$50.0 million federal fiscal relief grant that the State received in FY 2004 as part of the Jobs and Growth Tax Relief Reconciliation Act of 2003. The \$5.9 million decrease in the estimate for the unclaimed property transfer is a result of Fleet Financial Group's purchase by Bank of America and the anticipated transfer of non-Rhode Island source abandoned property and demutualization proceeds from Rhode Island's unclaimed property program to North Carolina's.

The revised FY 2004 estimate for the lottery transfer is \$283.1 million and the initial FY 2005 estimate is \$315.0 million. The revised November FY 2004 estimate is a decrease of \$18.7 million from the enacted FY 2004 estimate. Of this \$18.7 million decrease, \$18.0 million is attributable to a lowering of the estimate for the video lottery component of the lottery fund transfer. The revised growth in Lottery receipts in FY 2004 is 19.6 percent over preliminary FY 2003 collections. For FY 2005, the initial estimate of \$315.0 million represents growth of 11.3 percent over the revised November FY 2004 estimate.

The conferees revised FY 2004 estimated growth in the transfers to the general fund from video lottery terminals is 26.9 percent over preliminary FY 2003 revenues, for a total of \$215.0 million, a reduction of \$18.0 million from the enacted FY 2004 estimate. This \$18.0 million dollar decrease translates into a reduction of the growth in net terminal income from 21.8 percent to 18.3 percent. In FY 2005, the conferees estimated further growth of 12.9 percent in video lottery terminal transfers to the general fund, the total of which is \$242.7 million. The growth from FY 2004 to FY 2005 does not include any impact from the introduction of additional video lottery terminals in FY 2005 as current expansion plans have been put on hold indefinitely.

November 2003 Revenue Estimating Conference Forecasted Growth in General Revenues

	FY 2003 Preliminary	Growth	FY 2004 Enacted	Growth	FY 2004 Estimate	Growth
Personal Income Tax	\$813,342,788	0.7%	\$853,310,000	4.9%	\$854,900,000	5.1%
General Business Taxes						
Business Corporations*	63,861,292	94.9%	65,060,000	1.9%	68,500,000	7.3%
Public Utilities Gross	75,091,288	-7.1%	77,800,000	3.6%	77,800,000	3.6%
Financial Institutions	9,804,211	189.6%	1,500,000	-84.7%	(13,500,000)	-237.7%
Insurance Companies	51,287,425	58.5%	50,600,000	-1.3%	50,600,000	-1.3%
Bank Deposits	1,697,630	49.2%	1,430,000	-15.8%	1,730,000	1.9%
Health Care Provider	28,140,784	1.1%	40,940,000	45.5%	41,200,000	46.4%
Sales and Use Taxes						
Sales and Use	777,875,408	4.3%	812,205,533	4.4%	816,000,000	4.9%
Motor Vehicle	47,043,144	2.0%	48,200,000	2.4%	48,900,000	3.9%
Motor Fuel	1,022,168	25.8%	620,000	-39.3%	700,000	-31.5%
Cigarettes	94,379,288	10.4%	119,220,000	26.3%	121,400,000	28.6%
Alcohol	10,059,398	0.2%	10,300,000	2.4%	10,300,000	2.4%
Controlled Substances						
Other Taxes						
Inheritance and Gift	24,351,448	9.5%	30,700,000	26.1%	28,500,000	17.0%
Racing and Athletics	5,309,871	-2.9%	5,000,000	-5.8%	4,900,000	-7.7%
Realty Transfer	9,481,801	252.3%	8,900,000	-6.1%	10,800,000	13.9%
Subtotal Taxes	\$2,012,747,945	5.7%	\$2,125,785,533	5.6%	\$2,120,730,000	5.5%
Departmental Receipts						
Licenses and Fees	\$157,606,557	14.7%				
Fines and Penalties	29,825,081	20.9%				
Sales and Services	28,823,412	16.2%				
Miscellaneous	67,138,212	19.0%				
Subtotal Departmentals	\$283,393,263	16.4%	\$287,037,601	1.3%	\$287,000,000	1.3%
Taxes and Departmentals	\$2,296,141,207	6.9%	\$2,412,823,134	5.1%	\$2,409,730,000	4.9%
Other Sources						
Gas Tax Transfer	\$25,506,330	4564.4%	\$6,608,000	-74.1%	\$6,608,000	-74.1%
Other Miscellaneous	184,014,133	-20.8%	71,341,582	-61.2%	71,037,227	-61.4%
Lottery	236,636,756	10.5%	301,770,293	27.5%	283,100,000	19.6%
Unclaimed Property	8,458,048	14.0%	12,900,000	52.5%	14,490,000	71.3%
Total Other Sources	\$454,615,267	0.0%	\$392,619,875	-13.6%	\$375,235,227	-17.5%
Total General Revenues	\$2,750,756,474	5.7%	\$2,805,443,009	2.0%	\$2,784,965,227	1.2%

* Business Corporations and Franchise taxes were combined as of the May 2003 Revenue Estimating Conference.

November 2003 Revenue Estimates Compared to Enacted Revenue Estimates

	FY 2004 Nov Estimate	Change to Enacted	FY 2005 Nov Estimate	Change from Nov FY 2004	Growth
Personal Income Tax	\$854,900,000	\$1,590,000	\$893,100,000	\$38,200,000	4.5%
General Business Taxes					
Business Corporations*	68,500,000	3,440,000	70,000,000	1,500,000	2.2%
Public Utilities Gross	77,800,000	-	79,000,000	1,200,000	1.5%
Financial Institutions	(13,500,000)	(15,000,000)	8,500,000	22,000,000	-163.0%
Insurance Companies	50,600,000	-	51,400,000	8,000,000	1.6%
Bank Deposits	1,730,000	300,000	1,760,000	30,000	1.7%
Health Care Provider	41,200,000	260,000	45,100,000	3,900,000	9.5%
Sales and Use Taxes					
Sales and Use	816,000,000	3,794,467	850,000,000	34,000,000	4.2%
Motor Vehicle	48,900,000	700,000	50,500,000	1,600,000	3.3%
Motor Fuel	700,000	80,000	720,000	20,000	2.9%
Cigarettes	121,400,000	2,180,000	116,300,000	(5,100,000)	-4.2%
Alcohol	10,300,000	-	10,600,000	300,000	2.9%
Controlled Substances					
Other Taxes					
Inheritance and Gift	28,500,000	(2,200,000)	28,500,000	-	0.0%
Racing and Athletics	4,900,000	(100,000)	4,800,000	(100,000)	-2.0%
Realty Transfer	10,800,000	1,900,000	10,900,000	100,000	0.9%
Subtotal Taxes	\$2,120,730,000	\$(3,055,533)	\$2,221,180,000	\$98,450,000	4.6%
Departmental Receipts					
Licenses and Fees					
Fines and Penalties					
Sales and Services					
Miscellaneous					
Subtotal Departmentals	\$287,000,000	\$(37,601)	\$227,800,000	\$(59,200,000)	-20.6%
Taxes and Departmentals	\$2,409,730,000	\$(3,093,134)	\$2,448,980,000	\$39,250,000	1.6%
Other Sources					
Gas Tax Transfer	\$6,608,000	-	\$6,720,000	112,000	1.7%
Other Miscellaneous	71,037,227	(304,355)	10,116,632	(60,920,595)	-85.8%
Lottery	283,100,000	(18,670,293)	315,000,000	31,900,000	11.3%
Unclaimed Property	14,490,000	1,590,000	8,570,000	(5,920,000)	-40.9%
Total Other Sources	\$375,235,227	\$(17,384,648)	\$340,406,632	\$(34,828,595)	-9.3%
Total General Revenues	\$2,784,965,227	\$(20,477,782)	\$2,789,386,632	\$4,421,405	0.2%

* Business Corporations and Franchise taxes were combined as of the May 2003 Revenue Estimating Conference.